

***United States Court of Appeals
for the Second Circuit***



**APPELLANT'S
BRIEF**

ORIGINAL

74-2082

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P/S

United States Court of Appeals
FOR THE SECOND CIRCUIT

FOTOCHROME, INC.,

Debtor-Appellant,

—against—

COPAL COMPANY, LIMITED,

Claimant-Appellee.

BRIEF OF DEBTOR-APPELLANT

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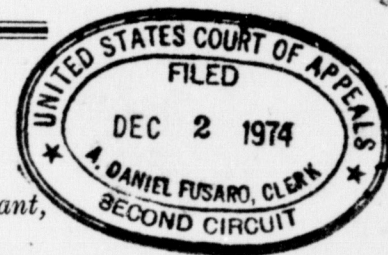




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UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

FOTOCHROME, INC.,

Debtor-Appellant,

-against-

COPAL COMPANY, LIMITED,

Claimant-Appellee.

Docket Number 74-2082

Brief of Debtor-Appellant

Preliminary Statement

The decision appealed from, reported at 377 F. Supp. 26, was rendered by Hon. Jack B. Weinstein. Judge Weinstein's decision reversed a decision, which has not been reported, of Referee in Bankruptcy, C. Albert Parente.

Statement of Issues Presented for Review

1. Is the Bankruptcy Court compelled to recognize the finality of a foreign arbitral award where the arbitrators failed to grant the debtor an opportunity to present its defense to the claim asserted by the claimant?

2. Do the treaties with Japan — the Treaty on Friendship, Commerce and Navigation and the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards — compel the Bankruptcy Court to grant the same finality to the arbitral award as allowed under Japanese law?

Statement of the Case

Nature of the Case

Claimant-Appellee, Copal Company, Limited ("Copal"), filed with the Bankruptcy Court a proof of claim based upon an arbitral award granted by the Japan Commercial Arbitration Association ("Japan CAA"). Debtor-Appellant, Fotochrome, Inc. ("Fotochrome"), filed objections to the allowance of the claim on the ground that the arbitral award was not final and binding upon the Bankruptcy Court and that

the court was empowered to examine and determine the merits of the claim underlying the award.

Course of Proceedings and
Disposition in the Courts Below

On the day following the filing by Fotochrome of a petition for an arrangement pursuant to Chapter XI of the Bankruptcy Act, the Referee in Bankruptcy ordered Fotochrome as debtor to continue in possession of its property. The referee also stayed the arbitration between Fotochrome and Copal then pending in Japan. The Japan CAA, nevertheless, pursued the arbitration to conclusion and granted its award in favor of Copal. Copal then filed in the Bankruptcy Court its claim based on the arbitral award, and Fotochrome thereafter filed objections to its allowance.

After the Referee had conducted an evidentiary hearing to supplement the record regarding the acts transpiring subsequent to the issuance of the stay order to Copal and the Japan CAA, he ruled that Fotochrome was entitled to a hearing on the objections to Copal's claim. (The referee's opinion and order appear in the Appendix at 116a-143a). Copal appealed the Referee's decision to the District Court where it was reversed. (The opinion and order of the District

Court appear in the Appendix at 144a-163a)

Statement of Facts

Fotochrome, a Delaware corporation with offices located in the Eastern District of New York, developed and patented a still camera possessing certain unique elements. In 1966 it contracted with Copal, a Japanese company with offices in Tokyo, to manufacture and produce the camera for distribution and sale in the United States. The written agreement between the parties provided for arbitration of disputes before the Japan CAA (15a, 20a-21a).

Under the terms of the agreement, Copal was to manufacture and deliver to Fotochrome 75,000 cameras during the nine month period from June 1966 through February 1967, with payment to be made by Fotochrome by letter of credit (21a). Fotochrome opened a letter of credit covering the cost of 19,300 cameras, but when Copal refused or was unable to comply with the agreement's delivery schedule, Fotochrome declined to establish a letter of credit for the remainder of the 75,000 cameras (23a-24a). The agreement scheduled delivery of 34,000 cameras through the end of October 1966, but Copal delivered only 19,300 (37a, 38a).

Thereafter, Copal filed its claim before the Japan CAA for damages of \$631,501(26a). Fotochrome counterclaimed for damages and loss of profits totalling \$828,582 (38a).

The first session of the arbitration was held on December 21, 1967 and subsequent sessions were conducted from time to time in 1968, 1969 and early 1970. Copal's last witness testified on January 27, 1970 and Fotochrome's witnesses were scheduled to appear to give testimony on March 31, 1970 (109a-110a). On March 26, 1970, however, Fotochrome filed a Chapter XI petition in the Bankruptcy Court (116a). On the day following, the Referee directed Fotochrome to continue as debtor in possession and issued an order staying all suits and arbitrations pending against the debtor (117a-118a).

The referee's stay order was cabled to Copal and the Japan CAA (111a-115a) and the latter was notified by Fotochrome's counsel that it could not present its witnesses on March 31, 1970 as scheduled (111a). Despite the stay, Copal urged the Japan CAA to allow the hearings to proceed (113a-114a). On July 2, 1970, without having heard Fotochrome's witnesses, the Japan CAA ordered the hearings closed (115a).

The arbitrators' award, dated September 18, 1970,

granted Copal recovery of damages of \$624,457 and denied Fotochrome's counterclaim in total (56a, 59a). On October 22, 1970, proof of claim in the sum of \$624,457 was filed by Copal in the Bankruptcy Court for the Eastern District of New York (13a).

POINT I

The Bankruptcy Court is not Compelled
to Recognize an Arbitral Award Where
the Award has not been Rendered in
Accordance with the Bankruptcy Act

A Trustee's Rights and Powers

Section 311 of the Bankruptcy Act (11, U.S.C. §711) provides that the Bankruptcy Court shall have "exclusive jurisdiction of the debtor and his property, wherever located." All property in possession of a bankrupt passes upon the filing of a petition in bankruptcy into the custody of the Bankruptcy Court. Having possession of the debtor's property, the court may issue all orders necessary to protect its possession from interference and it is entitled to determine all questions respecting its possession. Ex Parte Baldwin, 291 U.S. 610 (1933).

The arbitration in Japan was commenced before

Fotochrome filed its petition in bankruptcy. The award in favor of Copal, granted subsequent to the petition, upon deposit with the appropriate Japanese court, was conclusive, having the same effect as a judgment. Article 800 of the Japanese Code of Civil Procedure. Without obtaining confirmation of the award in the New York Supreme Court, Copal filed in the Bankruptcy Court a proof of claim based on the award, claiming that it was a provable debt under §63(a)(5) of the Bankruptcy Act [11 U.S.C. §103(a)(5)]. Section 63(a)(5) of the Act provides that debts of the bankrupt may be proved and allowed against its estate that are founded upon:

"(1) a fixed liability, as evidenced by a judgment or an instrument in writing, absolutely owing at the time of the filing of the petition.... and (5) provable debts reduced to judgments after the filing of the petition and before the consideration of the bankrupt's application for a discharge...."

In both instances, to allow the judgment as a claim is to treat it as conclusively fixing the existence and the amount of the bankrupt's liability. In re Barrett & Co., 27 F.2d 159 (S.D. Ga. 1928).

Judgments under subdivision (1) of §63(a) are of necessity against the bankrupt alone, having been rendered

prior to the bankruptcy. Judgments under subdivision (5), however, are binding upon the trustee in bankruptcy as he takes the estate subject to liabilities existing at the filing of the petition. The courts have held, however, that the trustee is bound to judgments rendered subsequent to the filing of the petition only if they are made pursuant to the provisions of the Bankruptcy Act. In the widely cited In re Barrett & Co., supra, the court distinguished those judgments obtained after the filing of the petition that would bind the trustee from those that would not.

"To make a fair and equal distribution of the estate to creditors through the federal courts is a prime object of the Bankruptcy Act. To accomplish it, it is just as important that the claims of the distributees be ascertained by the bankruptcy tribunal as that the bankrupt's property should be collected by it. That the distribution should be controlled by the judgment of other courts... would be most unfortunate....

The provable debts reduced to judgment after the filing of the petition, mentioned in section 63(a)(5), do not include all such judgments rendered against the bankrupt.... I am persuaded that only provable debts reduced to judgment after the filing of the petition pursuant to the provisions of the Act are meant. One such provision for reduction to judgment occurs in section 63(b), [now §57(d)]; 'Unliquidated claims against the bankrupt may, pursuant to application to the court, be liquidated in such a manner as it shall direct.' Liquidation by the trial

of a suit, if so directed, would result in a provable judgment. Liquidation by a trial against the wish of the bankruptcy court, and without the participation of its trustee, would not...." (emphasis in the original). At p. 161

The court then noted that §11 of the Act (11 U.S.C. §29) provides that the court may order a trustee to defend a suit pending against the bankrupt. If the trustee then defends, the court continued, he is of course bound by the judgment:

"but the Act studiously subjects his entrance into litigation in other courts to the direction of the bankruptcy court" (At p. 161)

Collier states that where the suit is commenced prior to the filing of the bankruptcy petition and will give rise to a judgment against the bankrupt, the trustee, neither having been made a party to the suit nor directed by the Bankruptcy Court to defend, will not be bound by the judgment:

"Where a suit is pending against the bankrupt at the time of bankruptcy, the receiver or trustee is entitled to apply for a stay of the action, or may apply to the bankruptcy court for leave to intervene.... But where the suit is one which gives rise to a judgment in personam

against the bankrupt, and the receiver or trustee was not made a party to the suit or directed by the bankruptcy court to defend it, the weight of authority is that such a judgment is not binding on the trustee as to the validity and amount of the claim in the bankruptcy distribution. Interested parties should, therefore, apply to the bankruptcy court for leave to continue a pending suit for the purpose of liquidation. In all cases, of course, the bankruptcy court, due to its equity powers, has full authority to inquire into fraud, collusion and similar circumstances affecting the validity of any claim asserted against the estate and to look behind the judgment to determine the essential nature of the liability for purposes of proof and allowance."

3 Collier on Bankruptcy, 14th Edition, §57.15, p. 260. See Vol. 3A, §63.27, p. 1902-1906 and Vol. 1A, §11.09, p. 1184-1188. See also In Re Paramount Publix Corp., 85 F.2d 42 (2nd Cir. 1936); In re Service Appliance Co., Inc., 39 F.2d 632 (N.D. N.Y. 1930); In re James A. Brady Foundry Co., 3 F.2d 437 (7th Cir. 1924); and In re Kenwood Storage and Warehouse Corp., 4 F. Supp. 561 (E.D. N.Y. 1930).

Fotochrome, as debtor in possession, had not been authorized to intervene in the arbitration in Japan. At the time that the arbitrators ruled that the hearings should be closed, the debtor was not a party in interest. The arbitral award, therefore, was not binding upon Fotochrome as debtor in possession.

The Debtor's Rights and Powers

A debtor in possession has the title and powers of a trustee in bankruptcy.

"Where no receiver or trustee is appointed, the debtor shall continue in possession of his property and shall have all the title and exercise all the powers of a trustee appointed under this title, subject, however, at all times to the control of the court and to such limitations, restrictions, terms and conditions as the court may from time to time prescribe."

Section 342 of the Bankruptcy Act (11 U.S.C. §742)

By reason of the agreement between Copal and Fotochrome, the Japan CAA had personal jurisdiction over Fotochrome. Once Fotochrome filed its petition in bankruptcy, however, jurisdiction of its property passed to the Bankruptcy Court. As a trustee was not appointed, Fotochrome as debtor in possession was the sole party having the power to defend against Copal's claim, but it could not exercise that power until authorized by the Bankruptcy Court. It was barred from defending unless directed by the court. In re Barrett & Co., supra.

The referee's order staying all suits and arbitrations was undoubtedly ineffective to enjoin the Japan CAA

and Copal from proceeding with the arbitration. But, at the time of the issuance of the order, Fotochrome was unauthorized to establish its defense to the claim asserted by Copal. The continuation of the arbitration proceeding was ex parte.

Lack of Due Process

As all Fotochrome's properties were located in the United States, Copal was aware that the enforcement of an arbitral award in its favor would of necessity bring it within the Bankruptcy Court's jurisdictional umbrella. It was also aware that if the Japan CAA disregarded the referee's order and proceeded with the arbitration, the award would most assuredly be in Copal's favor as Fotochrome had not yet presented its defense. In defiance of the court, Copal urged and ultimately convinced the Japan CAA to continue the hearings ex parte.

Why did the Japan CAA act precipitously? Until Fotochrome filed its Chapter XI petition, the arbitration had proceeded at a leisurely pace. Although Fotochrome answered Copal's claim on July 31, 1967, the first hearing was not conducted until December 21 of that year (109a). Eight hearings were held throughout 1968, only six in 1969

and one in early 1970 (109a-110a). Surely, there was no need to close the arbitration before it was ascertained whether Fotochrome would be empowered to proceed.

Under American concepts, Fotochrome was denied due process. The due process clause of the Fifth Amendment to the Constitution requires that a defendant in civil litigation be accorded the right to be present at every stage of the proceeding. Fillippon v. Albion Vein Slate Co., 250 U.S. 76 (1918).

Under the rules of the Japan CAA, Fotochrome had a right to present its defense through oral testimony. Instead of waiting until the Referee in Bankruptcy had granted the debtor in possession the authority to defend against Copal's claims, the Japan CAA closed the proceedings without hearing Fotochrome's defense. Instead of ordering Copal to apply to the Bankruptcy Court for leave to continue the arbitration, the Japan CAA ruled that it would decide the issues solely on the testimony of Copal's witnesses.

It cannot be denied that an arbitration conducted without regard to due process is not one conducted in accordance with the provisions of the Bankruptcy Act. Under the authorities cited above, the debtor in possession was not bound by the arbitral award, and thus the Referee in

Bankruptcy was correct in ruling that the merits of Copal's claim should be examined anew.

POINT II

The Treaties with Japan
do not Prohibit the
Bankruptcy Court from
Denying Finality to the
Arbitral Award

The District Court held that the treaties with Japan required the Bankruptcy Court to grant the arbitral award the same finality as it had been allowed in the Japanese courts (153a). The 1953 Treaty with Japan on Friendship, Commerce and Navigation provides for the enforcement of agreements to arbitrate.

"Awards duly rendered pursuant to any such contracts, which are final and enforceable under the laws of the place where rendered, shall be deemed conclusive in enforcement proceedings brought before the courts of competent jurisdiction of either Party, and shall be entitled to be declared enforceable by either such courts, except where found contrary to public policy."

Treaty with Japan on Friendship, Commerce and Navigation,
Art. IV, para. 2, 4 U.S.T. 2063 at 2068

The United Nations Convention on the Recognition and

Enforcement of Foreign Arbitral Awards, acceded to by the United States in 1970, contains a similar provision:

"Each contracting State shall recognize arbitral awards as binding and enforce them in accordance with the rules of procedure of the territory where the award is relied upon, under the conditions laid down in the following articles. There shall not be imposed substantially more onerous conditions or higher fees or charges on the recognition or enforcement of the arbitral awards to which this Convention applies than are imposed on the recognition or enforcement of domestic arbitral awards."

United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards, Art. III, 21 U.S.T. 2517 at 2519. The Convention, however, declares that recognition and enforcement of the award may be refused.

"1. Recognition and enforcement of the award may be refused, at the request of the party against whom it is invoked, only if that party furnishes to the competent authority where the recognition and enforcement is sought, proof that:

(b) The party against whom the award is invoked... was otherwise unable to present his case....

2. Recognition and enforcement of an arbitral award may also be refused if the competent authority in the country where recognition and enforcement is sought finds that:

(b) The recognition or enforcement of the award would be contrary to the public

policy of that country."

Art. V, 21 U.S.T. 2517 at 2520

One commentator has observed that the words "otherwise unable to present his case" incorporates in the treaty the basic concept of due process". Quigley, Accession by the United States to the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards, 70 Yale L.J. 1049 at 1067.

New York law also recognizes the failure to provide due process as ground for non-recognition of a foreign award.

"(a) No recognition. A foreign country judgment is not conclusive if:

1. the judgment was rendered under a system which does not provide impartial tribunals or procedures compatible with the requirements of due process of law."

C.P.L.R. §5304.

Having been denied the opportunity to present its defense through the oral testimony of its witnesses, Fotochrome has been made the victim of a procedure totally foreign to American concepts of due process. An arbitral award rendered under such procedures is obviously subject to attack. The United Nations Convention, therefore, did

not require the Bankruptcy Court to recognize the Japanese arbitral award as final and binding.

The Friendship, Commerce and Navigation Treaty as well as the United Nations Convention except from their enforcement provisions those arbitral awards found contrary to public policy of the country where enforcement of the award is sought. Public policy is to be found in the Constitution, the legislative acts, and the decisions of the courts. Building Service Employees International Union Local 262 v. Gazzam, 339 U.S. 532 (1949). Although the award of the Japan CAA in and of itself may not violate our public policy, the manner in which the award was obtained certainly does. The enforcement of an arbitral award, domestic or foreign, inherently defective by reason of a denial of due process, is abhorrent to our judicial processes. Of necessity, its enforcement would be contrary to our public policy.

The District Court recognized that the result of his decision was "troubling" (145a), and that it "might somewhat disturb the draftsmen of the Bankruptcy Act" (156a). The Court believed, however, that "some stability of expectation in the resolution of disputes through arbitration to protect against the uncertainties of foreign litigation seem desirable" (156a).

It is difficult to perceive that these expectations will be thwarted by reason of a trial on the merits before the Bankruptcy Court. Even the Japan CAA appeared to doubt that its award could be enforced in this country (57a). Copal, moreover, when served with the referee's order, was placed on notice that the Bankruptcy Court claimed jurisdiction over Fotochrome and its property. The filing of a petition in bankruptcy is "a caveat to all the world" International Bank v. Sherman, 101 U.S. 403 (1880). Copal could have readily predicted that its insistence that the arbitration proceed without the presence of Fotochrome would result in an attack on the award. The treaties were not intended to produce a "stability of expectation" at the expense of the law.

CONCLUSION

Fotochrome, as debtor in possession, lacked the authority to submit to the Japan CAA its defense to Copal's claim. The refusal of the arbitrators to order the hearings held in abeyance until Fotochrome's authority to proceed was granted, constituted, under American precepts, a denial of due process of law. Arbitral awards rendered without

due process are excepted from the enforcement provisions of the treaties with Japan. The decision and order of the District Court, therefore, should be reversed.

Respectfully submitted,

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certificates of three (3) copies of
the within *Brief*
having admitted this *29th* day
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